Notes for Meeting of December 13, 2000
Market Mechanisms for Student Loans
Student Loan Study Group 2—Section 801 Study

Attendees

Corye Barbour	United States Student Association
Bill Beckmann	Student Loan Corporation
Mary Bushman	AFSA Data Corporation, Fleet Boston Financial
Kathy Cannon	Bank of America
Judy Case	University of Massachusetts Medical School
Rene Champagne	ITT Educational Services, Inc.
Janice Daughtry-Miller	Independence Federal Savings Bank, Student Loan Department
Tony Dolanski	Sallie Mae, Inc.
Sarah Ducich	Sallie Mae, Inc.
Michael Hershock	Pennsylvania Higher Education Assistance Agency
Claire Mezzanotte	Fitch, IBCA Inc,
Dick George	Great Lakes Higher Education Corporation
James Lintzenich	USA Group
Gail Norris	Utah Higher Education Assistance Authority
Scott Miller	Pennsylvania Higher Education Assistance Agency
David Mohning	Vanderbilt University
Barmak Nassirian	American Assoc. of Collegiate Registrars and Admissions Officers
Susan Pugh	Indiana University
Marilyn Quinn	Delaware Higher Education Commission
Robert Scott	Adelphi University
Pat Smith	American Association of State Colleges and Universities
Paul Tone	UNIPAC
Harrison Wadsworth	Maine Education Services
Laurie Wolf	Des Moines Area Community Colleges
Paul Wozniak	Paine Webber Incorporated

Other government staff

Congressional Budget Office	Nabeel Alsalam
Department of Education	David Bergeron, Gail McLarnon, Maureen McLaughlin, David Madzelen, Daniel Pollard
Department of the Treasury	Robert Cumby, Lucy Huffman, Susan Lepper, Phil Quinn
General Accounting Office	Barbara Bovbjerg, Timothy Carr, Joy Gambino, Gene Kuehneman, Yesook Merrill, Diana Pietrowiak, Mitch Rachlis, Howard Wial
Office of Management and Budget	Lorenzo Rasetti

Introductory Remarks

The opening discussion dealt with the draft report as a whole rather than with its specific parts. Widespread sentiment was expressed that the report should place more emphasis on the effects of proposed market mechanisms on students and schools.

Gail Norris praised the draft report. He noted that the effects mentioned in the report are speculative, but had no solution for changing this aspect of the report. Pat Smith asked about the availability of the planned CBO report on student loan market mechanisms. Nabeel Alsalam responded that there was no definite timetable for it.

David Mohning wanted to see more emphasis on the effects of the proposed market mechanisms on students and schools. Bob Scott reiterated this and added that the report needs to emphasize the need for robust competition in the student loan market.

Laurie Wolf said that all the models discussed in the report assume that all components of the current FFELP are working effectively, which is not true. She also called for the addition of FDLP as a market mechanism because it provides competition for FFELP lenders. Bill Beckmann called for more emphasis on schools' preferred lender lists, which play an important role in competition in today's FFELP market.

Susan Pugh said that schools hire contractors all the time and called for consideration of a model in which schools can select lenders just as they select other contractors. Schools, either individually or in consortia, would issue RFPs that included performance standards for lenders.

Rene Champagne wanted to see more emphasis on the potential for lenders to "redline" certain schools and students under some proposed models. Also, frequent changes of lender would impose a burden on schools, which could have to change their hardware and/or software to accommodate new lenders. In addition, many market mechanism options would reduce competition among lenders.

Judy Case said that if schools are unable to deal with the technological problems involved in switching lenders, they will send students to the non-FFELP private loan market. Also, the report should say more about consolidation, viz., students lose deferments when they consolidate and consolidation could affect the availability of new loans.

Tony Dolanski also called for more material on the effects of market mechanism proposals on schools. Also, the relationship between servicing quality and the default rate, which affects government costs, should be addressed directly.

Bob Cumby praised the draft report but said that it misses the intensity of dissatisfaction with the status quo that motivated Congress to mandate the report.

Harrison Wadsworth wanted to see more attention paid to student costs. He called the draft report a good overview and said that it shows how difficult and complicated it would be to revise

FFELP. Further, Paul Wozniak said that the success of any option depends on servicing and that the report should include more material on how delivery systems would be affected.

Pat Smith said that HEA tries to avoid having Education use a large number of contractors. Many of the options discussed in the report would complicate Education's role. Schools are uneasy about options in which Education would limit the volume of loan money available. Currently all lenders receive the same SAP, which averages the risks of different schools together, making FFELP simpler for schools. Schools are comfortable with much of the status quo (other than the "2003 problem"), including the uniform SAP.

Paul Tone wanted the report to address the impacts of market mechanisms on schools' cash flows, what would happen to FDLP under each option, and whether consolidation loans would still be feasible under some of the proposed models. He said that the draft report did a good job in taking study group members' comments into account. Susan Pugh agreed with Tone's comment and also wanted the report to address the role of NSLDS, which she said does not currently work well.

Comments on Overview and Chapter 1

Tony Dolanski said that the Overview should include statistics on FDLP and mention the 98 percent limit on the federal guarantee. He and some other study group members disagreed with the Overview's statement that the federal government does not benefit from servicing improvements; they said that the government benefits because servicing improvements enable Congress to reduce the lender yield.

Rene Champagne said that the Overview should state that the study group had no consensus on the desirability of any of the options discussed in the report. Barbara Bovbjerg assured the group that the report would include a disclaimer to address this concern.

Lucy Huffman asked where (or whether) crosscutting issues would appear in the report. Barbara Bovbjerg indicated that GAO and Education had discussed a possible chapter 8 to highlight these crosscutting concerns. She asked the study group to consider these issues throughout the meeting but to hold their thoughts for a formal discussion later that day.

Tony Dolanski questioned the necessity of Table 2. If the table is to remain, he said, it should include effects on students, schools, and consolidation loans, the extent to which each model is market-based, and the extent of government intervention required in each model.

Paul Tone referred the group to his written comments on the entire report, which were circulated to group members before and during the meeting. He said that those comments reflected the views of some other study group members who collaborated with him in drafting them.

Barmak Nassirian objected to the bulk of the suggestions in Tone's comments. He stated that the draft report does a reasonably good job of capturing the study group's concerns and that it is impossible to obtain agreement on the minute details of the report. To the contrary, Sarah Ducich added that the bottom line of any proposed reform is lender yield. She stated that Tone's comments weren't wholly biased and that some should be included in the report to modify or supplement sections where indicated.

Someone said that the Overview should mention lender fees and expressed the opinion that the Overview captures Congress' dissatisfaction with the current method of setting the lender yield.

Rene Champagne said that in the unlikely event that any of the proposed market mechanisms produced savings for the federal government, the report should recommend what the government should do with those savings. Lucy Huffman disagreed, stating that the use of any savings is an issue for Congress to decide.

Susan Lepper expressed the view that the report should include a discussion of how, under some options, students would pay more than they do now because discounts would be eliminated. Lepper also believed that the report should say how any savings to the government would be (not "should be") distributed under each model.

Susan Pugh called for cross-chapter consistency in the end-of-chapter summary tables in addressing all points of the mandate.

Paul Tone noted that the draft report uses the term "lender" generically in some models, but that some models would change the role of the lender dramatically. He suggested using the term "winners of bids" in place of "lenders" in the auction chapters.

Barmak Nassirian wanted the Overview to explain the purpose and effect of the change to a Commercial Paper basis for the lender yield.

Nabeel Alsalam called for the Overview to include more material on the market for servicing: how many servicers exist and how the servicing market is concentrated. He also suggested eliminating the material on guaranty agencies from the Overview because guaranty agencies are not relevant to the report. Sarah Ducich disagreed, stating that some options discussed in the report would have a large impact on guaranty agencies; e.g. loan sales would leave guaranty agencies no role.

There was a discussion of how, if at all, consolidation would operate in the proposed market mechanisms. Paul Tone said that, in some models, it is not clear that consolidation could continue; e.g., it would compromise the purpose of an auction to allow consolidation. Tony Dolanski stated that the risk of consolidation, if predictable, would be factored into lenders' bids in any auction model. However, if that risk were unpredictable, then bids could not reflect it. Barmak Nassirian said that consolidation is appropriate in auction models because borrowers need the opportunity to exit from unsatisfactory lenders and because competition is improved and students benefit if a non-bidding consolidator can undercut a bidder. Gail Norris suggested the possibility of separate auctions for the right to make consolidation loans, and wanted the report to make this possibility explicit. Someone suggested that allowing consolidation in auction models would eliminate any federal savings that might result from the adoption of such models.

Corye Barbour added that the prospect of consolidation might drive up lenders' bids. She worried that this might discourage consolidation, but stated that taking away students' rights to consolidate may lead to higher default rates. Harrison Wadsworth agreed, stating that consolidation is an important alternative to borrowers. He worried that the consolidation option and an auction mechanism may be incompatible in practice. Rene Champagne wanted the report to include a comment that no student currently eligible for FFELP should be allowed to be "redlined" out of the program under any market mechanism model.

Comments on Chapter 2 (Adjustments to the Current System)

Susan Pugh said that more information on FDLP belongs in this chapter. She also wanted the chapter to include a flow chart for each model in addition to the summary tables that are already in the draft report.

Bill Beckmann said that the idea of reduced lender profits leading to greater efficiency and lower costs is false.

Michael Herschock expressed the view that the proposals in this chapter do less to alter the existing FFELP system than other proposals considered in the report. He also said that, contrary to the current draft report, establishing a blue-ribbon commission would not be difficult or expensive. He stated that the blue-ribbon commission could easily assemble a portfolio in the Direct Loan market every 90 days. The blue-ribbon commission could then auction this portfolio to discern the rates that lenders would bid. Judy Case agreed with this point, but Lucy Huffman questioned whether the rate at which the bundle sold would truly represent the fair market value of the portfolio. She noted that timing as well as the composition of the bundle offered would always impact price.

A lengthy discussion ensued regarding the possibility of having a blue-ribbon commission auction off a limited number of FDLP loans to obtain market information relevant to FFELP. Michael Herschock stated that HEA already gives the federal government the authority to auction FDLP loans and that these auctions would be easy and inexpensive to conduct for a small portfolio of FDLP loans. Gale Norris suggested that Direct Loans could be auctioned in various bundles to test the market, and that the report should say more about this possibility. Lucy Huffman agreed, with the reservation that portfolios would have to be auctioned frequently to ensure that auction results reflected up-to-date market conditions. Gail Norris noted that having a commission auction some loans is a new option that the study group had not previously considered. Nabeel Alsalam said that current federal budget-scoring rules are an obstacle to the sale of Direct Loans because such sales would always appear as budget losses. The same would be true, he stated, for sales of FFELP loans in the model presented in chapter 4 of the report. The effects of the market mechanism proposals on the federal budget, he suggested, is an issue that cuts across all chapters. Michael Herschock expressed the view that the mechanism used to test the FFELP loan market should be decided by a commission rather than by Congress. Harrison Wadsworth added that since the sale of Direct Loans was already authorized under HEA, perhaps the cost of this mechanism would be smaller than anticipated.

Judy Case asked whether there is any value in collecting data on what lenders charge for non-FFELP private loans. (Unlike FFELP loans, these loans do not have a SAP or federal guarantee.) Bill Beckmann said that the federal government already has the right to obtain data on FFELP lenders' costs.

The study group then discussed the sale of Direct Loans extensively, including the workings of ICR in loans that were sold. Pat Smith stated that borrowers would no longer have access to ICR if Direct Loans could be sold. Michael Herschock disagreed, saying that any loans auctioned would be sold with their original terms. Pat Smith raised the issue of who would administer ICR for Direct Loans that were sold to private lenders; a decision would have to be made as to whether the government or the private lender administered ICR. Barmak said that there could be annual or semiannual sales of Direct Loans without the need to change any terms of the borrower's promissory note. He expressed the view that these sales could be an easy way for the government to obtain information about lenders' costs without revolutionizing the structure of FFELP and could save the government a lot of money, but could result in higher rates. Judy Case said that it was important to keep the borrower in mind; if direct loans were sold, the entire portfolio of each borrower should be sold as a package. Rene Champagne proposed that portfolios of Direct Loans to be auctioned should be diverse rather than segregated by type of student. Susan Lepper agreed and suggested that market data could be combined with information obtained from Direct Loan sales.

Lucy Huffman asked whether the two assumptions made at the bottom of p. 27 of the draft report apply only to this chapter or throughout the report. She wanted the report to make the answer to this question clear.

Nabeel expressed concern that bidders would know that the results of their bidding on Direct Loans would affect the SAP they would receive on FFELP loans, and that this knowledge could influence their bids on Direct Loans. Michael Herschock said that it was unnecessary to address such details of auction design here; that should be left to experts. At the conclusion of this discussion, Susan Pugh expressed the view that any blue-ribbon commission should consist only of independent, objective members.

Comments on Chapter 3 (Origination Rights Auction)

Nabeel Alsalam and Laurie Wolf both proposed simplifying this chapter by eliminating some of the variations on the model. Nabeel suggested assuming that students would be able to keep all their loans from an academic program with the same lender and that bids would be expressed in terms of interest rates only. Laurie said that the right to lend should always include the obligation to lend. Nabeel agreed, saying that it would be impractical to split the two.

Judy Case asked whether secondary market loan sales would be possible under this model, and Nabeel Alsalam said that they would be possible. Further, Rene Champagne expressed the view that the administrative and technological burdens on schools of dealing with multiple lenders under this model are prohibitive.

There was an extensive discussion of whether grouping of schools under this model creates the possibility of discriminatory exclusion of some students from FFELP or reduced political support for FFELP. Rene Champagne argued that the grouping of schools is fraught with the danger of "redlining." Corye Barbour agreed and called for the report to say that all groups of loans to be auctioned should be mixed groups. Barmak Nassirian and Nabeel Alsalam disagreed. They argued that, as long as the student interest rate is uniform, the best way to prevent "redlining" is to allow homogeneous grouping of schools, so that lenders would receive higher subsidies for loans to students at "riskier" types of schools. Nabeel also said that Congress already knows, at least in general terms, that there are differences in the costs of loans made to students at different kinds of schools. Lorenzo Rasetti said that the most expensive loans for the federal government are high-balance loans, because the federal government must pay more in-school interest on them. Pat Smith expressed the view that it is a big political issue to have the federal payment to lenders differ according to the risk of lending to students at different schools. Having a uniform federal payment to lenders solves this problem, she said, although it is not efficient. Susan Pugh called this chapter the most disturbing of all the chapters. She said that it is dangerous to have an entire chapter devoted to origination rights auctions because this could lead to a discussion that no one wants. She wanted the report to say that the study group considered origination rights auctions as an option but did not discuss this option in depth. Gail Norris disagreed, but said this option would be very complex to administer.

Nabeel Alsalam expressed the view that this chapter is important and that origination rights auctions potentially have the least effect on FFELP of any proposed market mechanism because all FFELP participants keep their current roles. He said that there may be too many variations on the model and that some should be eliminated. He also suggested pre-certification of lenders by schools as a method of protecting schools' technological investments.

Laurie Wolf described this chapter as the scariest in the report, other than market-set rates. She called for more attention to the pros and cons of origination rights auctions and expressed concern about the perception that the fact that there is a planned CBO report on this option makes it look like the "preferred" option.

There was some discussion of the timing of auctions, including lessons from the HEAL program. Judy Case called for the report to say that some schools left the HEAL program because students got their money faster in the private market. She attributed the delays in disbursements in part to the fact that HEAL disbursements were tied to the federal government's fiscal year, which does not correspond to school calendars. David Mohning said that auctions should be conducted at least 12 months ahead of the academic year to provide reliable information to students. If this were not the case, he said, auctions could cripple schools' planning efforts. Paul Tone expressed concern about accommodating students whose schools have nontraditional calendars. David Mohning said that he did not know whether there was an answer to Tone's concern. Judy Case stated a preference for having fewer auctions earlier in time. Someone said that it is obvious from this chapter that schools and borrowers have risks in the origination rights auction proposal. Susan Pugh called for the report to say that lenders, schools, and students all hated HEAL. Gail Norris mentioned some pros and cons of various auction timing options and wanted to make sure that discussion of this issue was still in the report.

Harrison Wadsworth called for the report to say that it may be possible to solve all potential problems with origination rights auctions but at the cost of unacceptable administrative complexity. Paul Wozniak stated that, under origination rights auctions, students would not be able to maintain all their FFELP and private loans on a single bill, as they can now. Tony Dolanski expressed the view that there is a need for a full chapter on origination rights auctions. He said that school choice, which could be limited under this proposal, is important to preserve, and that it affects service quality, which in turn affects defaults.

Nabeel Alsalam wanted to know the magnitude of potential federal cost savings under this option. Additionally, David Mohning wanted the chapter to refer to “costs” rather than “burden” on schools and students. He said that some transfer of costs from government to schools is part of this proposal.

Comments on Chapter 4 (Loan Sales)

Judy Case said that schools’ decisions are based on local conditions. Her school prefers checks to EFT. She wanted to make sure that any proposed model continues the current diversity of payment systems. She also expressed the view that the effects of the loan sale model on borrowers and schools would not be minimal.

David Mohning questioned whether any non-governmental entity would have the ability to originate loans under a model that eliminated private lenders’ origination role. Bill Beckmann argued that centralizing loan origination, as in this model, would not be likely to simplify FFELP, and pointed to the FDLP experience as support for this argument. He also expressed the view that some borrowers’ costs would likely increase under this proposal because discounts would be eliminated, and that some school costs could also rise.

Pat Smith asked whether this proposal would require the federal government to sell all loans, regardless of price. Nabeel Alsalam said he assumed that the government would set a minimum price for loan sales. Bill Beckmann stated that because the government has a lower financing cost than private lenders, the government would lose money by selling loans to private lenders. Lorenzo explained how loan sales would be handled under current budget-scoring rules and concluded that the government could gain or lose by selling loans.

Susan Pugh said that this model is potentially well suited to emerging Internet-based just-in-time courses because it creates a “virtual lender” that can serve borrowers anytime and anywhere.

Kathy Cannon commented that the guiding assumptions were not clearly established in this model. She wondered if the purchaser of a loan would maintain discretion regarding service provision Nabeel Alsalam agreed that the motivation for this option is unclear and that the roles of participants are in the wrong places. He explained that this model was based on Don Feuerstein’s idea, which was to have lenders assume the risk of borrowers’ unwillingness to pay and have the government assume the risk of their inability to pay. A lot of this idea, he said, has been lost. Contrary to the assumptions of this model, he said, the government may not be the best originator and private lenders may not be the best funders.

Phil Quinn objected to the loan sale model as a "non-starter" because it has the government doing the originating and initial funding. He proposed an alternative model.

Susan Pugh expressed the view that the loan sale model, like FDLP, is not simple for schools.

Barmak Nassirian expressed his approval of the model as written and called for the report to present it in the most forceful and logical way possible. He also wanted the report to consider what would happen if students were not able to keep all their loans for a degree program with the same lender.

Gail Norris argued that the forced-sale feature of this model, with private origination, would lead to cutthroat pricing, which could reduce service quality. Laurie Wolf suggested that lenders could be pre-qualified as to servicing standards before they would be allowed to bid.

Barmak Nassirian reiterated the view that borrowers need to have the option to consolidate so that they can escape unsatisfactory lenders. He also expressed agreement with the idea of pre-qualifying lenders for service quality and stated that he wanted to ensure that students could keep all their loans for a degree program with the same lender. He called for a significant rewrite of this chapter to reflect these concerns.

Comments on Chapter 5 (Federal Funding)

Tony Dolanski said that the report's statement that under the non-auction version of this model, "[t]he pricing of federal funds for lenders would be a political decision," shifts the argument from the asset to the liability side of the balance sheet. He also asked about the concerns of federal agencies regarding this model.

Susan Lepper stated that she thought the study group had agreed to consider only the auction version of this model, since the non-auction version is not a market process. Sarah Ducich agreed that the auction version of the model is the only market mechanism in this chapter. Susan suggested that additional eligibility requirements might need to be imposed on lenders, that lenders would have to put up some equity of their own (i.e., she opposed 100 percent federal funding of FFELP loans), that FFELP loans would have to be collateral for the government in case of lender default, and that lenders should not be allowed to disburse FFELP loans before receiving federal funds.

Tony Dolanski asked why the federal government should fund student loans directly but not fund mortgages of Small Business Administration loans directly. Bob Cumby replied that the reason is because Congress already sets student loan interest rates.

Paul Tone expressed the view that, contrary to the statement in the draft report, this model would have large effects on FFELP participants and, in particular, that lenders would only be servicers. Someone suggested that the report should refer to "servicers" rather than "lenders" when discussing this model. Someone cautioned that it should not be assumed that traditional lenders would care to assume the role of servicers under this model.

Pat Smith expressed concern that loan availability could be a problem in this model and called for the report to address this issue in more detail.

Bill Beckmann commented on the implications of different auction designs for this model, saying that a single-price auction would make different schools differentially profitable for lenders, while a multiple-price auction would probably be politically unacceptable.

Tony Dolanski expressed the view that lenders would not want to finance student loans exclusively from federal funds. He said that lenders currently try to spread their risks by borrowing from multiple sources around the world.

Nabeel Alsalam stated that consideration of this model requires recognizing the full (opportunity) cost of using federal funds, which could equal lenders' cost. He also said that the other options considered in this report could incorporate federal funding and suggested that the chapter on federal funding should, therefore, be a cross-cutting chapter (like the chapter on income-contingent repayment) rather than a chapter about a particular model. He also said that if students pay a below-market interest rate, then federal funding would effectively be mandatory.

Sarah Ducich objected to the idea that federal funding is optional in this chapter. Without a SAP, she said, borrower interest rates could rise to the level of market rates and then federal funding would be optional. However, if borrower rates remained unchanged, then federal funding would be mandatory in effect.

Comments on Chapter 6 (Market-Set Rates)

There was a general discussion of whether the market should set borrower interest rates. Barmak Nassirian said that he did not think the legislative mandate was to find out the market rate for borrowers. He objected to the idea of market-set borrower rates on normative grounds and expressed the view that it is important to be attentive to the dangers of exposing unsophisticated student borrowers to market competition. Pat Smith asked whether the model would require borrower rates to be market-determined. Tony Dolanski replied that under the market-set rates model, borrower rates could be market-determined or not. He said that it would be acceptable if borrower rates were market-determined because students already choose schools in part on the basis of price (including student loan principal); it would not be much of a change to for students to include their loan interest rates in their price calculations. Barmak said that market-set borrower rates would be politically impossible; Pat Smith agreed. Barmak also described the proposal as undesirable public policy because FFELP is a federal entitlement program and the entitlement should not be sacrificed for gains in simplicity.

Tony Dolanski said that pure market-set rates would need a disclosure requirement for schools and borrowers so that they could shop effectively. He also stated that non-FFELP private student loans, which are an example of market-set rates, are growing.

There was a discussion of the extent to which rates would vary by student or school under this model. Laurie Wolf expressed concern about the possibility of lenders "redlining" schools under this model. She also said that not all students attending high-risk schools are high-risk borrowers. Nabeel Alsalam said that this model could allow the federal government to pay a uniform subsidy to all borrowers and that schools, rather than students, would probably do the shopping. For these reasons, he said, interest rate variation for students would be limited. Pat Smith wanted to keep open the possibility of having a fixed student interest rate under this model. Corye Barbour said that the model was upsetting because of the possibility of "redlining" and because student interest rates could increase overall. Rene Champagne expressed concern about lenders engaging in unlawful price discrimination by charging different interest rates by type of school; Bob Cumby replied that price discrimination is lawful if it does not impede competition.

Barmak Nassirian said that this chapter could be harmful if put into public discourse without the necessary cautions. He said that students are the intended beneficiaries of FFELP and that lenders should not be able to pass the basis risk to them absent a comprehensive discussion of the entire program along with a proposal that would lower borrower rates. He called for the report to include a discussion of the circumstances that led to a change in the basic index for the lender yield.

Tony Dolanski and Gail Norris stated that the government could limit the range of interest rates that lenders could charge student borrowers and could also require lenders to disclose all their FFELP interest rates to all schools. These requirements plus the federal guarantee, Tony Dolanski said, would keep interest rate variation across students small.

Pat Smith wanted the report to point out that the current FFELP has a single SAP for both high- and low-risk students. All of the proposals in the report deal with this somehow, but Congress could be trading one set of political problems for another by adopting one of those proposals. Congress would be arguing with school and student lobbyists instead of lender lobbyists, she said. Further, Corye Barbour wanted the report to be more explicit about which students would be harmed by this model, and that this should be included in the chapter's summary table.

Lorenzo asked how this model could work without market-set borrower rates. Sarah Ducich replied that it could not. Sarah Ducich also stated that she thought the chapter was biased against market-set rates but that some other study group members think it is biased in favor of them, so that the chapter may be all right.

Susan Lepper suggested that the question whether different students should pay different interest rates is a cross-cutting issue for Chapter 8.

Nabeel Alsalam said that the interaction of FFELP and FDLP should not be ignored. Low FDLP interest rates limit the interest rates that lenders could charge under this model and limit the ability of this model to function, he stated. Paul Tone said that in this model, unlike the others discussed in the report, borrowers can get the benefit of the market.

Tony Dolanski suggested a fixed subsidy to students in order to keep student rates low. This would make the subsidies in the program explicit, he said. Pat Smith objected that Tony's suggestion would still allow interest rates to vary across students. Rene Champagne suggested a change in the Direct Loan program that would allow the government to determine how differential interest rates would impact student participation.

Chapter 7 (Income-Contingent Repayment (ICR))

Much of the discussion was about the possibility and desirability of having private lenders hold ICR loans.

Gail Norris wanted the report to show how income verification and the administration of federal subsidies for privately held ICR loans could actually work. He expressed concern about whether ICR could work with private lenders unless the federal government reimbursed lenders for the costs of ICR subsidies.

Harrison Wadsworth expressed the view that the ICR appendix does not seem to fit with chapter 7 and also said that foreign ICR programs might not fit well into the U.S. student loan system.

Judy Case stated that the goal of ICR is to assist low-income students. Since ICR already exists in the DL program, she said, the government could continue meeting this population's needs without modifying FFELP. She wondered why students couldn't simply consolidate into a Direct Loan to take advantage of this existing option. Harrison Wadsworth wondered if ICR loans could be serviced by the government but not purchased by the government. Scott Miller thought there were financial but not legal impediments to doing so, but stated that borrowers should have an ICR option without having to consolidate if they didn't want to. Lorenzo Rasetti questioned if there were rules making the holding of an ICR loan impractical due to negative amortization. Harrison Wadsworth did not think this was the case. David Bergeron stated that there should be the possibility of the federal government servicing ICR loans without buying them.

Barmak Nassirian expressed discomfort with having private lenders administer ICR. He said that lenders would not want ICR loans unless the government paid them a subsidy for such loans. His view was that ICR is pure social policy and not something that lenders would want to do. Someone responded that lenders participate in FFELP, which is a public-private partnership designed to achieve a social goal.

Issues to Consider

Barbara Bovbjerg suggested four cross-cutting issues: (1) the role of FDLP in each market mechanism; (2) how the market mechanisms would be scored for budget accounting purposes; (3) additional material on how the market mechanisms would affect borrowers, schools, and lenders, including distributional issues among borrowers; and (4) the distribution of any federal savings between the federal government and other FFELP participants, especially borrowers.

The following study group members suggested the following issues to consider.

Study Group Member	Suggested Topic(s)
Pat Smith	• How any savings from the market-set rates model could be shared with students

	• Whether or not the Departments of Education and Treasury could effectively administer any of the proposed changes to FFELP
Robert Cumby	Differential pricing
Susan Lepper	Savings to the government (possibly shared with other FFELP participants) in each model
Nabeel Alsalam	• Keeping students as well off as they are today • Sources of cost savings from market mechanisms: (1) lenders' excess profits (if any), (2) technological progress, (3) simplification of FFELP
Gail Norris	• More on gains and risks from each proposal. (But he does not really expect the report to include this.) • Government savings could come at expense of service quality or borrower discounts. • Scheduled 2003 change in lender yield
Susan Pugh	Elimination of origination fee
Scott	Risk of disruption during the transition to any reform
Judy Case	Use of technology: large changes have already happened; do not expect much additional saving from technology. (Tony Dolanski and Pat Smith disagreed.)
Harrison Wadsworth	• Look back at what was said at beginning of this meeting • Mention market mechanisms that now exist in FFELP and the benefits accrued to students as a result of rigorous competition
Barmak Nassirian	• Simplify due diligence requirements • Much marketing effort by lenders is wasted